

ANALYSIS OF ORIGINAL BILL

Author: Leach Analyst: Paul Brainin Bill Number: AB 2026

Related Bills: See Legislative History Telephone: 845-3380 Introduced Date: 02-18-98

Attorney: Doug Bramhall Sponsor:

SUBJECT: Child Care Credit/"The Family Choice Child Care Act of 1998"

SUMMARY

This bill would allow a credit equal to the greater of 30% of a federal credit provided under Internal Revenue Code (IRC) section 24 or \$150 for each child under 18 years of age for child care expenses.

EFFECTIVE DATE

This bill would be effective immediately as a tax levy, but specifies it would be operative for each taxable year beginning on or after January 1, 1999.

LEGISLATIVE HISTORY

AB 90, AB 183 (95/96), AB 26, AB 66, SB 39 (93/94)

SPECIFIC FINDINGS

Current federal law provides an exemption (indexed annually for inflation) deduction, of generally \$2,650 for each qualifying child under the age of 19 or student under the age of 24, when computing taxable income.

Beginning for tax years 1998, **federal law (IRC section 24)** generally provides taxpayers with a non-refundable, non-carryover tax credit, known as the child tax credit, for each qualifying child under the age of 17 (although the credit may be refundable in certain limited circumstances for taxpayers who have three or more qualifying children). The credit (allowed irrespective of whether any child care expenses have been incurred by the taxpayer) is \$400 for taxable year 1998, and \$500 for 1999 taxable years and thereafter. A qualifying child is defined as an individual for whom the taxpayer can claim a dependency exemption and who is a son or daughter of the taxpayer (or descendent of either), a stepson or stepdaughter of the taxpayer, or an eligible foster child of the taxpayer.

DEPARTMENTS THAT MAY BE AFFECTED:

___ STATE MANDATE

___ GOVERNOR'S APPOINTMENT

Board Position:

___ S ___ O
___ SA ___ OUA
___ N ___ NP
___ NA ___ NAR
___ X ___ PENDING

Agency Secretary Position:

___ S ___ O
___ SA ___ OUA
___ N ___ NP
___ NA ___ NAR
DEFER TO ___

GOVERNOR'S OFFICE USE

Position Approved ___
Position Disapproved ___
Position Noted ___

Department Director Date
Gerald H. Goldberg 4/8/98

Agency Secretary Date

By: Date

For taxpayers with modified adjusted gross income (AGI) in excess of certain thresholds, the sum of the otherwise allowable child credit is phased out. The phase-out rate is \$50 for each \$1,000 of modified AGI (or fraction thereof) in excess of the threshold. For married taxpayers filing joint returns, the threshold is \$110,000. For taxpayers filing single or head of household returns, the threshold is \$75,000. For married taxpayers filing separate returns, the threshold is \$55,000. These thresholds are not indexed for inflation.

Existing federal law (IRC section 21) allows a credit against tax of 20%-30% (depending on the taxpayer's adjusted gross income) of employment-related costs of child care for a dependent who is under the age of 13 or who is physically or mentally unable to care for oneself. Employment-related expenses are defined, generally, as those expenses incurred to enable gainful employment.

California had a similar credit based upon expenses for household and dependent care services necessary for gainful employment. That credit was a percentage of the amount of credit allowed by section 21 of the IRC; the percentage was based upon the taxpayer's AGI and ranged between 15% and 30%, inclusive. That credit provision was repealed by its own terms December 1, 1993.

Existing state law does not allow a credit based solely on a taxpayer having a dependent child under the age of 17. California also does not provide a dependent exemption deduction. Instead, California provides a non-refundable, non-carryover exemption credit for qualifying dependents. Following enactment of the federal child tax credit, California, in SB 1233 (Stats. 1997, Ch. 612), increased the dependent exemption credit from \$68 to \$120 for 1998 and to \$222 in 1999. The \$222 will be adjusted for inflation beginning in year 2000. California has conformed to the definition of dependent under federal law.

Under existing state law, these exemption credits also have a phase-out provision if AGI exceeds certain limits. For 1997, the phase-out thresholds start at \$144,152 for single taxpayers, \$228,305 for married taxpayers filing joint, and \$171,228 for head of household filers. For single taxpayers the credit is reduced by \$6 for each \$2,500 by which the taxpayer's AGI exceeds the threshold amount. For married taxpayers filing joint, the credit is phased out by \$12 for each \$2,500 by which the taxpayer's AGI exceeds the threshold amount. Additionally, exemption credits cannot reduce regular tax below tentative minimum tax for alternative minimum tax purposes.

California conforms to federal law as of a specific date. Currently, California is conformed to the IRC as it read January 1, 1997.

This bill would allow a credit equal to 30% of section 24 of the IRC.

(Note: As of January 1, 1997, the IRC contained no section 24. Section 24, relating to contributions to candidates for public office, was repealed for tax years beginning after 1986. The Tax Reform Act of 1997 added a new section 24 of the IRC, which provides for the child tax credit. However, the author's staff has indicated that the intent was to allow either a credit equal to 30% of the federal child care credit, as under prior law, or a credit of \$150 per child. (Department staff will work with the author in drafting language to reach that end.)

This bill would allow a carryover of any portion of this credit which exceeds net tax until the credit is exhausted.

Policy Considerations

This credit would not have a sunset date. Credits generally have sunset dates to allow periodic review by the Legislature.

The author's intent is to relate this credit to the federal credit for employment-related costs of child care for a dependent who is under the age of 13, rather than the new federal child tax credit. An age discrepancy would exist between a qualifying child or dependent qualifying for the child care credit and a child qualifying for the \$150 credit:

- 30% of the federal amount allowed for a qualifying child of the taxpayer under the age of 13; or
- \$150 per child under 18 years of age for child care expenses.

If the intent is to provide a credit for child care expenses, it is unclear why the "under 18" age was selected.

Implementation Considerations

This bill would allow a choice of credits, while no other credit for individuals is allowed on an "either-or" basis. The choice may create confusion for taxpayers.

This bill defines neither child nor child care expenses.

The addition of this credit would cause numerous revisions to forms and booklets that could be implemented during the normal annual forms update cycle.

The bill does not define when the child must be "under 18" (beginning of year, end of year). This may lead to disputes between taxpayers and the department. The federal child care credit (for expenses for household and dependent care services necessary for gainful employment) looks to the close of the taxable year as the controlling date.

Because of the tentative minimum tax limitation on special credits, taxpayers claiming this credit would be forced to file Form 540, which may be confusing to taxpayers used to filing the Form 540A.

This bill would allow the credit to be carried over indefinitely. Credits generally have a limited carryover since credits usually are exhausted after eight years.

FISCAL IMPACT

Departmental Costs

If the implementation concerns were resolved, this bill would not significantly impact the department's costs.

Tax Revenue Estimate

The following analysis reflects the intent of the author to base the credit on the federal child care credit (IRC section 21), rather than the federal child tax credit (IRC section 24).

Revenue losses under the Personal Income Tax Law (PITL) are estimated as follows:

Effective on or After January 1, 1999 Assumed Enactment After June 30, 1998 (millions)		
1998-9	1999-0	2000-1
(\$15)	(\$145)	(\$150)

This analysis does not consider the possible changes in employment, personal income, or gross state product that could result from this measure.

Tax Revenue Discussion

Revenue losses under the PITL would depend on the number of taxpayers who have children under the age of 18 with qualified child care expenses and available tax liabilities to apply this credit against.

The above estimates were based on the department's personal income tax model projections. Special programming was done to reflect the federal law credit (for a percentage of the child and dependent care expenses necessary to be gainfully employed, pursuant to IRC section 21). It is estimated that this credit would benefit approximately 600,000 filers for the 1999 tax year.

The estimate for the first fiscal year above includes only 10% of the 1999 tax year impact. This impact results from reduced estimated tax and withholding payments.

BOARD POSITION

Pending.